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No. 87-1117

In the Supreme Court of the United States

OCTOBER TERM, 1987

CITY OF MANASSAS, VIRGINIA, ET AL., APPELLANTS

v.

UNITED STATES OF AMERICA

ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MOTION TO AFFIRM

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QUESTION PRESENTED

Whether Section 58.1-3502 of the Virginia Code Annotated (1984) unconstitutionally discriminates against the United States by requiring contractors to pay local personal property tax on federally-owned property that they use in performing their government contracts, while exempting from the tax property owned by certain Virginia governmental bodies that is similarly used by contractors.

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Pursuant to Rule 16.1 of the Rules of this Court, the Solicitor General, on behalf of the United States, moves that the judgment of the United States Court of Appeals for the Fourth Circuit in this case be affirmed.

OPINIONS BELOW

The opinion of the court of appeals (J.S. App. A1-A11) is reported at 830 F.2d 530. The opinion of the district court (J.S. App. A13-A21) is reported at 627 F. Supp. 645.

JURISDICTION

The judgment of the court of appeals was entered on October 6, 1987. The notice of appeal was filed on December 23, 1987 (J.S. App. A22-A23), and the appeal was docketed on January 4, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(2).

STATEMENT

1. Since 1981, the United States Defense Logistics Agency has supervised approximately 29 Defense Department contracts that the Federal Systems Division of International Business Machines Corporation (IBM) has performed at its facility in Manassas, Virginia. These contracts primarily involve services performed for the Navy in research and development, design, assembly, and testing of signal processing and submarine sonar systems. Pursuant to these contracts, the United States provides IBM with government property, including machinery and tools, for use in performance of these government contracts but not for use in performance of nonfederal contracts or for its own account. The United States pays IBM a fee for these services, which constitutes IBM's profit on the contracts. The United States pays all expenses incurred in IBM's performance of the services. J.S. App. A2.

On June 23, 1981, the City of Manassas informed IBM that it was subject to personal property tax with respect to the property furnished to it by the United States for use in performing its federal service contracts. The Virginia statute, now codified at Section 58.1-3502 of the Virginia Code Annotated (1984), provides that a company that leases or borrows personal property from a governmental body is liable for local taxation as if it were the owner of the property.[1] The statute expressly exempts from its pro-

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[1] Section 58.1-3502 provides:

> Any person, firm, association, unincorporated company, or corporation engaged in business for profit who or which leases, borrows or otherwise has made available to it any tangible personal property to be used in such business from any agency or political subdivision of the federal, state or local governments shall be liable to local taxation, unless otherwise exempted or partially exempted by state or local laws, to the same extent, in the

visions property owned by the Virginia Port Authority or by certain local transportation districts.[2] Under protest, IBM paid the personal property taxes demanded by the City of Manassas for the years 1981-1984, which totalled $290,365. Pursuant to its "cost-plus" contract arrangement, the United States reimbursed IBM for the tax payments. J.S. App. A3.

2. The United States then instituted this action in the United States District Court for the Eastern District of Virginia. The complaint sought a declaratory judgment that the Virginia statute is unconstitutional because it discriminates against the United States, a refund of the taxes paid, and injunctive relief (see J.S. App. A13). The district court granted summary judgment in favor of appellants (*id.* at A13-A21). The district court recognized that the statute is "discriminatory on its face" (*id.* at A17) in exempting property furnished to contractors by the Virginia Port Authority or local transportation districts from the tax burden placed on property furnished by the United States. But the court held that this discrimination

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same manner, and on the same basis as if the lessee were the owner thereof. This section shall not apply to any such property owned by the Virginia Port Authority and leased in connection with the operation of piers and marine terminals and related facilities, or to property owned by any transportation district organized under the Transportation District Act of 1964 (§ 15.1-1342 et seq.) and leased to provide transportation services.

[2] Prior to July 1, 1980, the statute had applied only to property *leased* from the government (Va. Code Ann. § 58-831.2 (1950)); it was amended in 1980 to subject to taxation also property borrowed from the government. Although the language of the exemptions continues to refer to property "leased" from the Port Authority and the transportation districts, it is not disputed that the local taxing authorities, consistent with the clear legislative intent of the amendment, also apply the exemptions to property borrowed from or otherwise made available by the exempted Virginia governmental bodies.

is "justified" because the Port Authority and transportation districts both involve areas "of vital concern to the Federal Government as well as the state" (*ibid.*).

The court of appeals reversed (J.S. App. A1-A11). Relying on *Phillips Chem. Co.* v. *Dumas Indep. School Dist.*, 361 U.S. 376 (1960), the court explained that a state is not free to impose a use tax that discriminates against the federal government. The court found that here "the discrimination against the federal government in favor of subdivisions of the state government is obvious," and it rejected the district court's conclusion that that discrimination could be justified because the affected state instrumentalities are involved in areas assertedly of "vital concern" to the United States (J.S. App. A6). The court explained that facially discriminatory treatment cannot be justified by examining the relative strength of the interests at stake. Rather, it can be justified only by "a showing that the two classes of users, from federal and state sources, are not similarly situated, so that in essence there is no discrimination" (*id.* at A9). The court concluded that no such justification had been offered to support the facially discriminatory treatment in the statute, and therefore the statute is unconstitutional (*id.* at A10-A11).

ARGUMENT

The court of appeals correctly concluded that the Virginia statute is unconstitutional because it discriminates against the United States. It is well settled that a tax is invalid, even if it is not imposed directly upon the United States, " 'if it operates so as to discriminate against the Government or those with whom it deals.' " *Moses Lake Homes, Inc.* v. *Grant County*, 365 U.S. 744, 751 (1961) (quoting *United States* v. *City of Detroit*, 355 U.S. 466, 473 (1958)). Clearly, the burden of the local per-

sonal property tax involved here falls upon the United States, in that the cost-plus contract arrangement obliges the government to reimburse IBM for its tax liability. And there can be little doubt that Va. Code Ann. § 58.1-3502 (1984) operates in a discriminatory fashion in imposing the tax upon property owned by the United States, but not imposing it in similar circumstances upon property owned by certain Virginia state instrumentalities. The court of appeals found that "the discrimination against the federal government in favor of subdivisions of the state government is obvious" (J.S. App. A6), and appellants do not take issue with this conclusion. Even the district court recognized that the statute is "discriminatory on its face" (*id.* at A17). Thus, the decision below is soundly based on principles well established by this Court.

Appellants' defense of the Virginia statute is not spelled out in detail, but it appears to be the ground relied upon by the district court—namely, that the discriminatory treatment in the statute is "justified" by certain policy considerations. Relying on a statement made by this Court in *Phillips Chem. Co.* v. *Dumas Indep. School Dist.*, 361 U.S. 376, 382 (1960), the district court held that the fact that the state instrumentalities favored by the statute are involved in areas of "vital concern" to the federal government justifies the discrimination by the State (J.S. App. A17-A18). This holding was correctly rejected by the court of appeals as based on a clear misinterpretation of *Phillips*.

The facts in *Phillips* were quite similar to those here. Texas law subjected persons leasing property from the federal government to the local ad valorem tax on that property, but it imposed a distinctly lesser burden on similarly situated lessees of property owned by the State. The Court stated (361 U.S. at 382): "The discrimination against the United States and its lessee seems apparent. The question, however, is whether it can be justified." The

Court then framed the relevant inquiry as whether the State has "single[d] out those who deal with the Government * * * for a tax burden not imposed on others similarly situated"; the disparate treatment "must be justified by significant differences between the two classes" (*id.* at 383). The Court rejected the justifications offered by the State—that the State could collect in rent what it lost in taxes from its own lessees, that the favoritism for state lessees advanced the State's interest by facilitating the leasing of its property and that the federal leasing was of greater magnitude—as "too impalpable to warrant" the disparate treatment (*id.* at 384, 387). The Court concluded that the State is required to "treat those who deal with the Government as well as it treats those with whom it deals itself" (*id.* at 385).

This Court's opinion in *Phillips* clearly indicates, as the court of appeals here correctly stated, that the only "justification" that would support a statute discriminating against the United States is "a showing that the two classes of users, from federal and state sources, are not similarly situated, so that in essence there is no discimination" (J.S. App. A9).[3] Appellants make no attempt to provide such a justification. They simply suggest that the exemptions for the state instrumentalities serve the "public good" or are

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[3] *United States* v. *Department of Revenue*, 202 F. Supp. 757 (N.D. Ill.), aff'd, 371 U.S. 21 (1962), which is cited by appellants (J.S. 8), is a case where a tax was upheld as nondiscriminatory because the two classes treated differently were found not to be similarly situated. The case involved a local occupation tax, levied upon sales, that applied to sales to all governments, but did not apply to certain classes of tax-exempt organizations. The court held that the fact that the governments could raise revenue by taxation, but the exempt organizations had to depend upon voluntary contributions, provided a reasonable basis for conferring a tax exemption on sellers to the exempt organizations that was not accorded to sellers to the governments. 202 F. Supp. at 759.

"conducive to the welfare of the general public" (J.S. 8), presumably because the Port Authority and transportation districts engage in projects that promote the general welfare. Quite apart from the fact that there is no basis for assuming that the federal projects subject to taxation are not at least equally beneficial to the public welfare, the policy considerations advanced by appellants and the district court simply fail as a matter of law to justify a statute that taxes the United States, or those with whom it deals, in a discriminatory fashion. The Constitution does not permit a state to further its own interests or policies by granting itself preferential tax treatment vis-a-vis the federal government (even if it believes that its policy goals are shared by the United States).[4]

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[4] The court of appeals found it unnecessary to reach two other possible grounds for invalidating the Virginia statute, even if the preference for state instrumentalities were found not to be unconstitutionally discriminatory. First, the Virginia taxation scheme does not tax users of property that is owned by tax-exempt organizations. Thus, the taxation scheme "treats someone else better than it treats" those who deal with the federal government. *Washington* v. *United States*, 460 U.S. 536, 544-545 (1983) (citation omitted). That is not permissible if the two classes are similarly situated.

Second, the federally-owned property here was made available to IBM only for use in performing its government contracts; the property could not be used for its own account or in performing nonfederal contracts. These limitations clearly made the value of any interest that IBM had in the property substantially less than the full ownership value of the property. Accordingly, the assessment of the personal property tax upon the full value of the federal property exceeded the maximum that could reasonably be viewed as being imposed on IBM's interest; rather, it was, at least in part, an unconstitutional tax on property of the United States. See *United States* v. *New Mexico*, 455 U.S. 720, 741 n.14 (1982); *United States* v. *County of Fresno*, 429 U.S. 452, 463 n.11 (1977); *United States* v. *County of Allegheny*, 322 U.S. 174, 186-187 (1944); *United States* v. *Colorado*, 627 F.2d 217 (10th Cir. 1980), aff'd, 450 U.S. 901 (1981).

Appellants rely primarily on the Sixth Circuit's decision in *Chrysler Corp.* v. *Township of Sterling*, 410 F.2d 62 (1969). That case involved a Michigan statute that placed a tax on the private use of property, including property owned by the federal government, but exempted the use of property of state-supported educational institutions. A divided court of appeals upheld the tax. The court first stated that there was no discrimination as a practical matter against the United States because the amount of exempted property involved was "infinitesimal" by comparison to the total amount of tax-exempt real estate in the State (410 F.2d at 69-70). The court further concluded that whatever discrimination was involved in the statutory scheme was "justified" within the meaning of *Phillips* (*id.* at 73). The justification apparently relied upon by the court for the statutory classification was the "well recognized policy of both the United States and the State of Michigan to protect, promote and support education" (*id.* at 70) and the fact that the United States provided financial support to the exempted Michigan institutions (*id.* at 70-71).

Despite its different factual context, to the extent the *Township of Sterling* decision rests on the proposition that a tax statute that discriminates against the United States can be justified by reference to some state policy that is advanced by the preferential treatment, it is at odds with the decision below. As we have explained, however, that proposition completely misconstrues *Phillips* and was correctly rejected by the court below. We do not believe that the existence of the *Township of Sterling* decision presents a conflict in the circuits that merits review by this Court. *Township of Sterling* has never been followed by any other court (other than the district court in the present case). Moreover, in the period since *Township of Sterling* was decided this Court has had occasion to consider other cases

involving state taxation that burdens the federal government, and its more recent decisions should put to rest any possible suggestion that *Phillips* permits a discriminatory tax to be justified on the basis of an assertion that the preferred entities engage in activity that promotes the general welfare. For example, in *United States* v. *County of Fresno*, 429 U.S. 452, 462 (1977) (footnote omitted), the Court noted that a state tax on those who deal with the federal government is constitutional "so long as the tax is imposed equally on the other similarly situated constituents of the State." See also *Washington* v. *United States*, 460 U.S. 536, 544-545 (1983); *United States* v. *New Mexico*, 455 U.S. 720, 735 n.11 (1982). It is highly questionable whether the Sixth Circuit would continue to regard *Township of Sterling* as good authority in light of the more recent pronouncements of this Court.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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